MEMORANDUM FOR: D/SOVA
D/EURA

This is the full text of the agreed report of the group of experts on credits to the USSR.

Maurice Ernst
NIO/Econ

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Report of the Group of Experts on Credits to the USSR

The Group of Experts met in Washington May 20-21 and considered the issues raised in its mandate.

The Experts' report follows and includes:

1. An agreed dossier on the present Soviet Hard currency position and prospects for the future. The Experts also agreed on a format for participant presentations of the highlights of their bilateral relations with the USSR.

2. A review of the technical feasibility for different countries of alternative credit restraint mechanisms (including raising fees for guarantees and insurance).

3. A review of the issue of equalizing burdensharing among countries adopting different restraint measures and the need for a monitoring mechanism.

## The Common Dossier

The Experts' discussion of a common dossier was conducted in two parts, namely (1) a review of the Soviet hard currency position and prospects, and (2) a survey of each participant's bilateral economic relations with the USSR. The group agreed on a short text and a collection of data summarizing their views on the first item, as follows.

## The Soviet Hard Currency Position and Prospects

### Basic Facts

-- The Soviet hard currency position has worsened in the last 18 months as a result of falling oil prices, poor harvests, sluggish Western markets and Poland's financial needs.

-- In response to this situation the USSR has sold more gold in a depressed market, cut imports and increased its use of short term credit.

-- Gross Soviet debt at the end of 1981 totaled $21 billion. With hard currency assets of about $8 billion in Western banks, net debt amounted to about $12.6 billion.

-- Net debt service payments amounted to about $5 billion in 1981, which results in a moderate debt service ratio of under 20 percent.

## Key Judgements

### Prospects for Soviet Hard Currency Earnings

The purchasing power of Soviet hard currency earnings is unlikely to increase and may decline during the next few years (through the mid-1980's).

o The volume of oil exports to the West will probably continue to decline; oil prices have fallen sharply in real terms during the past year and oil market conditions do not appear conducive for a price increase in real terms in the next few years.

o Higher Soviet earnings from gas exports will probably not offset the decline in oil exports at least until the Yamal pipeline is completed.

o Prospects for other Soviet exports are mixed: although exports of some products, especially chemicals, should increase, it will be difficult for the Soviets to avoid declines in earnings from exports of wood and arms.

Export prospects for the late 1980's and beyond are far more uncertain than those for the next few years. Oil export volume may decline further or oil exports may cease; on the other hand real oil prices may increase, and there would be time to develop other exports.

### Soviet Import Possibilities

The Soviets apparently have been planning for increases of 2 to 3 percent a year in the volume of imports from the West during 1981-85.

The performance of the Soviet economy has been far worse than planned, both in industry and in agriculture. The longer-term outlook is for a rate of Soviet economic growth inadequate to sustain the rapid expansion of military spending while at the same time raising consumer welfare -- in other words, the Soviet economic setting will be greatly different than in the past.

A deterioration of economic performance will make additional imports from the West especially valuable to the USSR. But if Soviet export earnings stagnate or decline in the next few years, imports cannot be increased without a growing net outflow of Western capital to the USSR, which would mean a further increase in the Soviet hard currency debt.

Soviet Policy Conerning Western Credits and Hard Currency Debt

In past years, Moscow has followed cautious balance of payments and debt policies, but to avoid a substantial accumulation of hard currency debt will require painful steps on Moscow's part. Additional import cuts would involve either very high priority projects, major products in short supply, especially steel, or politically sensitive grain imports.

Table 1

USSR: Hard Currency Payments, 1975-1981

(Million US $)

| | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981[a] |
|---|---|---|---|---|---|---|---|
| Trade balance | -6,419 | -5,595 | -3,300 | -3,794 | -2,036 | -2,519 | -4,000 |
| Exports, f.o.b. | 7,838 | 9,721 | 11,345 | 13,157 | 19,549 | 23,498 | 23,800 |
| Imports, f.o.b. | 14,257 | 15,316 | 14,645 | 16,951 | 21,585 | 26,017 | 27,800 |
| Gold sales | 725 | 1,369 | 1,618 | 2,522 | 1,490 | 1,780 | 2,700 |
| Net interest | -568 | -716 | -846 | -881 | -799 | -710 | -1,300 |
| Arms receipts | 1,200 | 1,500 | 1,500 | 1,700 | 5,500 | 3,300 | 5,000 |
| Other invisibles and transfers | 351 | 511 | 1,800 | 1,823 | -360 | 1,600 | 1,000 |
| Current account balance | -4,711 | -2,931 | 772 | 1,370 | 3,795 | 3,451 | 3,400 |
| Direct investment abroad | -3 | -31 | 0 | 0 | 0 | 0 | 0 |
| Gross drawings | 6,689 | 6,632 | 4,031 | 4,165 | 5,311 | 3,333 | 6,100 |
| Government backed | 1,972 | 2,611 | 1,991 | 2,565 | 2,411 | 2,433 | 2,300 |
| Commercial | 4,717 | 4,021 | 2,040 | 1,600 | 2,900 | 900 | 3,800 |
| Repayments | 1,287 | 2,445 | 3,238 | 3,443 | 3,625 | 4,061 | 3,300 |
| Government backed | 730 | 1,056 | 1,305 | 1,476 | 1,722 | 1,966 | 2,000 |
| Commercial | 557 | 1,389 | 1,933 | 1,967 | 1,903 | 2,095 | 1,300 |
| Lending to other countries[b] | 295 | -1,711 | 140 | -1,582 | -2,926 | 200 | 200 |
| Capital account balance | 5,694 | 2445 | 933 | -860 | -1,240 | -528 | 3,000 |
| Statistical discrepancy[c] | 980 | 468 | 1,705 | -510 | -2,555 | -2,923 | -6,400 |

a Estimated
b Net changed in Soviet assets held with Western commercial banks (a negative sign signifies an addition to assets).
c Includes intra-CEMA hard currency trade and other transactions.



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Table 2

**USSR: Hard Currency Imports**

| | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 |
|---|---|---|---|---|---|---|---|---|---|---|
| Millions of current US dollars | | | | | | | | | | |
| Total | 2,943 | 4,157 | 6,547 | 8,448 | 14,257 | 15,316 | 14,645 | 16,951 | 21,585 | 26,017 |
| Grain | 185 | 770 | 1,423 | 509 | 2,323 | 2,627 | 1,354 | 2,360 | 3,279 | 4,360 |
| Other agricultural products | 475 | 423 | 933 | 1,273 | 1,533 | 1,458 | 1,836 | 1,476 | 2,287 | 4,400 |
| Machinery | 960 | 1,252 | 1,739 | 2,334 | 4,593 | 5,074 | 5,114 | 5,969 | 6,028 | 6,039 |
| Rolled ferrous metals | 365 | 489 | 854 | 1,905 | 2,565 | 2,251 | 1,750 | 2,503 | 3,413 | 3,469 |
| Chemicals | 213 | 257 | 279 | 720 | 742 | 630 | 670 | 831 | 1,203 | 1,565 |
| Other | 744 | 936 | 1,289 | 1,707 | 2,501 | 3,276 | 3,921 | 3,810 | 5,375 | 6,184 |
| Millions of constant US dollars (1970) | | | | | | | | | | |
| Total | 2,705 | 3,547 | 4,242 | 5,118 | 7,268 | 8,254 | 7,470 | 7,292 | 8,430 | 9,166 |
| Grain | 185 | 733 | 730 | 196 | 997 | 1,257 | 670 | 937 | 1,100 | 1,183 |
| Other agricultural products | 484 | 295 | 339 | 615 | 751 | 715 | 649 | 471 | 757 | 1,419 |
| Machinery | 946 | 1,149 | 1,353 | 1,622 | 2,700 | 2,929 | 2,827 | 2,716 | 2,512 | 2,350 |
| Rolled ferrous metals | 215 | 321 | 583 | 1,074 | 1,030 | 1,147 | 909 | 1,113 | 1,423 | 1,330 |
| Chemicals | 211 | 253 | 261 | 510 | 460 | 376 | 307 | 347 | 435 | 580 |
| Other | 664 | 793 | 976 | 1,101 | 1,330 | 1,830 | 2,108 | 1,705 | 2,203 | 2,299 |

This table is Unclassified.

**USSR: Hard Currency Exports**

| | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 |
|---|---|---|---|---|---|---|---|---|---|---|
| Million current US dollars | | | | | | | | | | |
| Total | 2,630 | 2,801 | 4,790 | 7,470 | 7,838 | 9,721 | 11,345 | 13,157 | 19,549 | 23,498 |
| Petroleum | 567 | 556 | 1,248 | 2,548 | 3,276 | 4,514 | 5,275 | 5,462 | 9,558 | 12,028 |
| Natural gas | 20 | 23 | 23 | 86 | 220 | 347 | 566 | 1,063 | 1,404 | 2,706 |
| Coal and coke | 125 | 121 | 135 | 252 | 391 | 370 | 359 | 293 | 313 | 362 |
| Machinery and equipment | 184 | 225 | 299 | 341 | 560 | 657 | 789 | 1,188 | 1,419 | 1,388 |
| Ferrous metals | 131 | 134 | 204 | 222 | 167 | 171 | 186 | 145 | 225 | 246 |
| Wood and wood products | 360 | 403 | 714 | 1,009 | 712 | 852 | 1,045 | 967 | 1,357 | 1,476 |
| Chemicals | 73 | 75 | 118 | 261 | 256 | 215 | 229 | 300 | 555 | 765 |
| Agricultural products | 346 | 347 | 414 | 685 | 572 | 627 | 730 | 545 | 570 | 478 |
| Diamonds | 257 | 371 | 515 | 545 | 478 | 511 | 606 | 773 | 1,043 | 1,304 |
| Other | 567 | 546 | 1,120 | 1,521 | 1,206 | 1,457 | 1,560 | 2,421 | 3,105 | 2,745 |
| Million constant US dollars (1970) | | | | | | | | | | |
| Total | 2,430 | 2,423 | 2,601 | 2,865 | 2,848 | 3,174 | 3,308 | 3,962 | 4,044 | 3,686 |
| Petroleum | 441 | 406 | 437 | 375 | 476 | 588 | 813 | 747 | 611 | 592 |
| Natural gas | 13 | 26 | 26 | 65 | 91 | 156 | 182 | 221 | 273 | 273 |
| Coal and coke | 80 | 78 | 83 | 92 | 86 | 89 | 88 | 70 | 65 | 58 |
| Machinery and equipment | 153 | 169 | 195 | 199 | 277 | 319 | 314 | 514 | 566 | 507 |
| Ferrous metals | 156 | 164 | 222 | 232 | 182 | 174 | 123 | 142 | 141 | 134 |
| Wood and wood products | 361 | 402 | 445 | 387 | 361 | 449 | 427 | 405 | 380 | 328 |
| Chemicals | 77 | 97 | 114 | 188 | 159 | 129 | 143 | 196 | 324 | 403 |
| Agricultural products | 336 | 219 | 173 | 252 | 264 | 227 | 256 | 175 | 138 | 112 |
| Diamonds | | | | | | | | | | |

Table 3

SSR: Hard Currency Debt to the West

Million US $
Except as noted

| | 1971 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981[a] |
|---|---|---|---|---|---|---|---|---|
| mercial debt | 400 | 6,900 | 9,700 | 9,800 | 9,500 | 10,500 | 10,000 | 12,500 |
| ernment-backed debt | 1,400 | 3,600 | 5,200 | 5,900 | 7,000 | 7,800 | 8,200 | 8,500 |
| ss debt | 1,800 | 10,500 | 14,900 | 15,700 | 16,500 | 18,300 | 18,200 | 21,000 |
| ets with Western banks | 1,200 | 3,100 | 4,700 | 4,500 | 6,000 | 8,800 | 8,600 | 8,400 |
| debt | 600 | 7,400 | 10,200 | 11,200 | 10,500 | 9,500 | 9,600 | 12,600 |
| t service | 300 | 1,800 | 2,300 | 3,100 | 4,100 | 4,000 | 4,900 | 5,300 |

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Table 4

USSR: Comparative Debt Service & Debt Service Ratios, 1981

| | |
|---|---|
| **Exports (Billion US $)** | |
| Merchandise exports | 23.8 |
| Merchandise & arms exports | 28.8 |
| Merchandise, arms & gold exports | 31.5 |
| Merchandise, arms, gold exports, & net invisibles | 32.5 |
| **Debt Service (Billion $)** | |
| Repayments | 3.3 |
| Official | 2.0 |
| Commercial | 1.3 |
| Interest payments | 2.0 |
| Official long and medium term | 0.5 |
| Commercial long and medium term | 0.7 |
| Short term | 0.8 |
| Gross debt service | 5.3 |
| Net debt service | 4.6 |
| **Gross & Net Debt Service Ratios[a]** | |
| Gross debt service as percent of: | |
| Merchandise exports | 22.3 |
| Merchandise & arms | 18.4 |
| Merchandise, arms, and gold | 16.8 |
| Merchandise, arms, gold and invisibles | 16.3 |
| Net Debt Service as a Percent of: | |
| Merchandise exports | 19.3 |
| Mechandise and arms | 15.9 |
| Merchandise, arms, and gold | 14.6 |
| Merchandise, arms, gold and invisibles | 14.1 |

a Gross Basis -- Debt service calculated on gross interest payments.
Net Basis -- Debt service calculated on net interest payments.

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As regards the experts' survey of bilateral economic relations with the USSR, most delegations found that they did not have all the relevant data and analysis at hand. They did agree, however, that this subject can best be presented via (a) a set of key facts and figures arranged in a commonly-agreed format, and (b) short (one-page) analyses to be prepared by each delegation. The agreed format for the data is displayed on the following page. The experts agreed to furnish to all delegations the completed tables, plus their analytical texts, by Thursday, May 27.

Country Data Sheet Outline
(in National Currencies)

| | 1970 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 |
|---|---|---|---|---|---|---|---|---|
| **A. Trade Data*** | | | | | | | | |
| Total Exports to World | | | | | | | | |
| Total Exports to USSR | | | | | | | | |
| of which: Food and Agriculture (SITC 0,1,4) | | | | | | | | |
| Raw Materials (SITC 2) | | | | | | | | |
| Energy (SITC 3) | | | | | | | | |
| Chemicals (SITC 5) | | | | | | | | |
| Manufactured Goods (SITC 6) | | | | | | | | |
| Machinery (SITC 7) | | | | | | | | |
| Other (SITC 8,9) | | | | | | | | |
| Total Imports from World | | | | | | | | |
| Total Imports from USSR | | | | | | | | |
| of which: Food and Agriculture | | | | | | | | |
| Raw Materials | | | | | | | | |
| Energy | | | | | | | | |
| Chemicals | | | | | | | | |
| Manufactured Goods | | | | | | | | |
| Machinery | | | | | | | | |
| Other | | | | | | | | |
| **B. Trade Balance with the World** | | | | | | | | |
| Trade Balance with the USSR | | | | | | | | |
| **C. Credit Data** | | | | | | | | |
| Total Commitments (maturities greater than one year) | | | | | | | | |
| Direct Official | | | | | | | | |
| Guaranteed | | | | | | | | |
| Private | | | | | | | | |
| Total Disbursements (maturities greater than one year except short-term) | | | | | | | | |
| Direct Official | | | | | | | | |
| Guaranteed | | | | | | | | |
| Private | | | | | | | | |
| **D. Credits less than one year (change during the course of the year)** | | | | | | | | |
| Direct Official | | | | | | | | |
| Guaranteed | | | | | | | | |
| Private | | | | | | | | |

* Countries may also submit one page of commentary.

The Technical Feasibility of Various Credit Management Options

The experts' mandate required them to consider, under item (2) the possibility of raising insurance, guarantee, or commitment fees, and, under item (3) examples of techniques which could be analyzed under the rubric of burdensharing. It was agreed rapidly and virtually without discussion that the raising of fees is a technically feasible step for all participants.

The Group's views on fees and other possible mechanisms for credit management are displayed in the matrix format presented on the following page, with notes. The experts agreed that the Yes/No responses provided in the matrix relate only to the strictly legal/technical feasibility of the various measures within the individual national systems. They do not represent policy judgements. The attached footnotes attempt to explain certain nuances adduced by various delegations in elaboration of their judgements on technical feasibility.

TECHNICAL FEASIBILITY OF MECHANISMS TO RESTRICT CREDITS TO THE SOVIET UNION

Country Responses on Technical Feasibility (Yes/No)

| EDIT MEASURES | FR | FRG | UK | IT | CAN | JAP | US |
|---|---|---|---|---|---|---|---|
| **total** value of export transaction: | | | | | | | |
| -- Increase cash payment as a percentage of the export value or transaction | no[1] | yes | yes | yes | yes | yes | yes |
| - Require full cash payment on coming into force of commercial contract | no[1] | yes | yes | yes | yes | yes | yes |
| financed portion of transaction | | | | | | | |
| - Reduce insured percentage of loss on the contract | yes[4] | yes[4] | yes[3] | yes[6] | YES[11] | no[2] | yes |
| - Reduce the percentage of official financing | yes[5] | NA | yes[3] | yes[6] | yes | no[7] | yes |
| - Limit maximum repayment terms on new officially supported credits to a maximum of five years | no[1] | yes | yes | yes | yes | yes | yes |
| - Eliminate official local cost financing or guarantees for local cost financing 8/ | yes | yes | yes | yes | yes | yes | yes |
| - Increase insurance premiums, guarantee fees and/or commitment fees for direct credits | yes | yes | yes | yes | yes | yes | yes |
| - Reduce volume of official commitments in excess of one year | no[10] | yes[9] | yes[9] | yes[9] | yes[9] | yes[9] | yes |

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1/ Protocol

2/ 1-yr contract with exporters' association. Feasible at end of contract, but severe practical difficulties.

3/ But severe practical difficulties. For UK, infringes on existing government agreement with banks.

4/ But FRG and France believe that this could mean end of bank financial credits. Hence very difficult.

5/ But difficult to accept. In this connection, France has no obligation under the Protocol with respect to interest rate, or with respect to the blend of official support and bank financing which makes up the required 85 percent financing under the Protocol.

6/ Would raise cost of financing to exporter.

7/ Because of blended-rate requirement under new Consensus. Increase in private portion would reduce the blended rate.

8/ All except Japan do not support local cost financing. Japan presently does. If the USSR moves into Consensus Category 1, local cost support will be banned in any case.

9/ But with severe burdensharing reservations.

10/ France is normally obliged to finance contracts signed by French enterprises. But the contract approval process is not automatic. It is possible to scrutinize contracts more closely and to re-examine the approval process.

11/ Could have potential burdensharing problems for Canada.



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## Burdensharing and Monitoring

The application of different restraint mechanisms by different countries to moderate flows of credit to the USSR appears to be the only practical solution, in terms of technical feasibility. Several combinations of mechanisms could be contemplated but, clearly, any such solution requires a satisfactory mechanism for burdensharing.

The Group of Experts reviewed the problems of burdensharing. The Experts did not offer final views on specific burdensharing formulas in the absence of decisions on the exact package of measures to be adopted by each country. They did agree that it would be technically feasible to compute equivalent burdensharing packages for different mechanisms and that the Group could rapidly meet again to work out specific burdensharing modalities if the broad outlines of a compromise could be agreed upon at a higher level.

The Experts agreed that burdensharing formulas cannot fully account for all differences in the attractiveness of the alternative packages. Nor can they provide ironclad proof against evasion, mistakes, or deficiencies in design. The Group of Experts agreed, therefore, that semiannual reviews of the system, based on transparency and full exchanges of information among participating countries is essential. The information exchange should cover all officially supported and private credits, both long and short term, and should include data on transaction values, official support commitments (direct credits and guarantees), disbursements, undrawn commitments, scheduled repayments of principal and interest, and bilateral trade data.

While delegations expressed no final views on the advisability of any one combination of measures, they prepared some illustrative examples of possible approaches to the burdensharing question. These examples are described in the attached Annex to this Report. They are not exhaustive of the possibilities and they do not imply judgements on whether they would be satisfactory and acceptable actions on credits to the USSR.

## Examples of Burdensharing Solutions For Combinations of Measures That Are Technically Feasible for Different Countries

### Introduction

A basic principle of burdensharing involves consistency of practice among Participants. The Experts recognized, for example, that, should a country adopt some form of reduction in cover for a transaction as a whole (e.g. less guarantee cover or less direct credit), it could unilaterally offset the effects at least in part by altering its practice to apply greater cover to the riskier later maturities and lesser cover to the less risky, more "bankable" earlier maturities. This problem of burdensharing *vis a vis* countries which take other actions can be cured by the simple device of agreeing to continue the current practice whereby the covered and uncovered portions of a financing are repaid, *pari-passu*, across all maturities such that official (or officially covered) and uncovered creditors bear equivalent risk over the life of the contract. With this sort of consistent practice established among Participants by agreement, the design of burdensharing mechanisms such as those illustrated below acquires greater simplicity and transparency.

### Examples

1. A package of measures that appears as a possible combination based on the technical feasibility matrix would

have most countries agree to increase the cash payment to, for example, 40 percent of contract value and reduce the repayment period to five years. Other countries could choose to reduce the percentage of official financing. Private financing, at a higher interest rate, would be used to finance the balance of the 85 percent financed portion of the transaction. The blended interest rate (for 85 percent cover at 8.5 years) would thus be higher.

The burdensharing problem in a case like this can be solved by adjusting the blended interest rate for the 85 percent loan on the basis of a present value calculation. Some delegations suggested that another analytical approach to the same end could be the use of a "grant element" formula, and all delegations agreed that other technical approaches exist as well. Accounting for the use of different currencies also was mentioned. The key point which would be recognized in any formula is that the degree of restrictiveness implied by a reduction in cover and/or maximum maturity can be matched in a burdensharing sense by an increase in the cost of a credit with greater cover and/or longer term -- and that the burdensharing equivalence can be calculated, subject to verification by a monitoring mechanism.

2. In a variation on the combination of measures described above, those countries which did not choose to raise downpayments and/or limit official support could adopt an overall

quantitative limit on their total credits to the USSR. A straightforward method is available for calculating such a limit so that the burden borne by all countries is equivalent.

3. As was reflected in the Experts' technical discussions, increases in insurance, guarantee, or commitment fees are feasible for all countries. Here, burdensharing considerations are relatively straightforward and, in fact, can be embodied automatically in any increase that would be negotiated, in the sense that Participants could agree to uniform proportional changes in such "up-front" charges such that no loss in perceived competitiveness relative to the status quo ante would result.